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UK Financial Reporting Council Publishes Updated Guidance on Modifications of Audit Opinions and Reports

April 23, 2020

See our past alert on March 20

In its March guidance for auditors, the UK Financial Reporting Council (FRC) recognised the practical difficulties some companies and auditors are facing in preparing accounts and carrying out audits. The FRC highlighted the possibility that current circumstances may require auditors to modify their audit opinion.

The FRC updated this guidance on 21 April 2020 to elaborate on certain factors that auditors should take into account when considering whether to modify an audit opinion. These factors are (i) whether the auditor has been able to obtain sufficient, appropriate audit evidence to form an opinion on whether the financial statements are free from material misstatement and (ii) how pervasive any error may be to the financial statements.

The FRC have identified the following ways in which audit opinions may be modified:

- **Qualified opinion:** Where an auditor concludes that there is either a lack of sufficient appropriate audit evidence or actual (or potential) material misstatements in a set of financial statements, but that it is limited to a specific set of balances, transactions or disclosures, then the qualification of the auditor's opinion only applies to those items. (This is not the same as a "limitation of scope", where an auditor is prevented by management from obtaining sufficient appropriate audit evidence; when this is the case, the auditor may withdraw from an engagement, give a qualified opinion or disclaim their opinion.)
- **Adverse opinion:** Where the auditor concludes on the basis of sufficient, appropriate evidence that material and pervasive misstatements exist that undermine the reliability of the financial statements as a whole then they give an "adverse" opinion.
- **Disclaimer of opinion:** Where the auditor has not been able to obtain sufficient, appropriate audit evidence to be able to give an opinion but concludes that potential material and pervasive misstatements may exist, then they "disclaim" their opinion entirely.

Additional disclosures within the auditor's report which *do not* affect or change the auditor's opinion, and which remain unqualified are:

- **Key audit matters:** These are matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. Key audit matters are a standard feature of audit reports for listed entities, intended to provide useful additional information to investors and other users.
- **An emphasis of matter:** Emphasis of matter paragraphs do not change the audit opinion. They are used by auditors to draw the attention of users to a matter that the auditor thinks is important to their understanding of the financial statements.
- **Certain disclosures relating to going concern:** It is only where the auditor concludes that management's proposed approach to the use of the going concern basis of accounting is not appropriate, or that there is insufficient disclosure about a material uncertainty, that a modified opinion will arise. Where the use of the going concern basis is not appropriate, the auditor gives an adverse opinion. Where there is insufficient disclosure about a material uncertainty, the auditor gives either a qualified or adverse opinion. Where there is insufficient evidence to support management's determination that the financial statements should be prepared on a going concern basis, the auditor disclaims their opinion. In this case, the auditor's conclusions are set

out in a separate dedicated part of their report.

The **FRC have published a flowchart** setting out the decision-making process an auditor follows when considering a modified opinion and the circumstances that apply in each case.

Additionally, the Institute of Chartered Accountants in England and Wales have published a useful **Q&A on audit reports**.

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